

**BEFORE THE
PUBLIC SERVICE COMMISSION OF WISCONSIN**

Application of Wisconsin Energy Corporation for
Approval to Acquire the Outstanding Common Stock of
Integrus Energy Group, Inc.

Docket No. 9400-YO-100

**REBUTTAL TESTIMONY OF STEVEN J. VOCK
FOR JOBS4WI, INC.**

February 19, 2015

1 **Q. Please state your name and business address.**

2 A. My name is Steven J. Vock. My business address is The Titus Group (Titus Energy)
3 1200 N. Mayfair Road, Suite 270, Milwaukee, Wisconsin 53226.

4 **Q. Are you the same Steven J. Vock who submitted Direct Testimony in this**
5 **proceeding?**

6 A. Yes, I am.

7 **Q. What is the purpose of your Rebuttal Testimony?**

8 A. I am responding to the Direct and Rebuttal Testimony submitted by Messrs. Reed,
9 Leverett and Lauber of the Applicant and Ms. Bartels of the PSCW staff in this docket
10 submitted on or after January 14, 2015, pursuant to the PSCW Order (Ref#: 230661) filed
11 January 29, 2015.

12 **Q. In his rebuttal testimony, Mr. Reed discusses the statutory requirement in Wis.**
13 **Stat§196.795(3) that the proposed transaction is in the “best interests” of utility**
14 **customers, investors and the public. Do you agree with his analysis?**

15 A. No. Mr. Reed's interpretation of “best interests” on Page 6 of his rebuttal testimony is
16 incorrect. Mr. Reed suggests that the appropriate standard is the equivalent of a “do no

1 harm” test, stating the “transaction should not cause harm in terms of service, costs,
2 environmental protection, safety and economic impacts” (Rebuttal-WEC-Reed-6) Mr.
3 Reed also states that any potential benefits must be “viewed from the perspective of these
4 stakeholders taken as a whole.” (Rebuttal-WEC-Reed-6) Mr. Reed’s interpretation takes
5 significant liberty with Wisconsin Statute 196.795(3) which states that the acquisition
6 must be in the best interests of utility consumers, investors and the public."

7 In order for the transaction to be in the "best interests" of the public, customers and
8 shareholders, it must be in the "best interest" of each of them. Each must be better off
9 after completion of the proposed transaction than before the proposed transaction and this
10 standard must be met for each of these groups individually, not as an undefined collective
11 benefit. The statute is conjunctive and requires a transaction to be in the “best interest”
12 of each of the members of the stakeholder group.

13 I agree with Mr. Reed’s statement, "the benefits of the transaction should exceed its
14 costs and risks” (Rebuttal-WEC-Reed-6), but I disagree with his application of that
15 statement. The Applicants provide no absolute savings to offset their costs, provide no
16 comparison showing how their proposed future is better than the status quo and ignore
17 the risks introduced by this transaction.

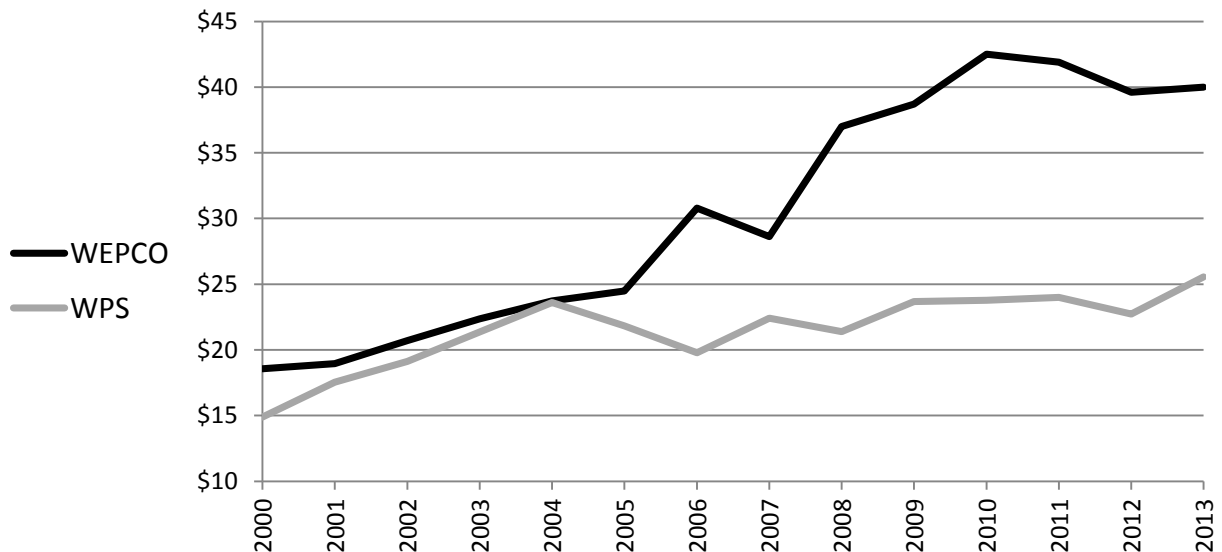
18 It is the responsibility of the Applicants to demonstrate that this standard has been met
19 for each of the defined stakeholder groups and they have fallen short of this goal.

1 **Q. How do you define the "best interests" of customers?**

2 A. Customer “best interests” must be measured by the things that impact customers,
3 which are improved reliability and lower costs. The Applicant offers no support or
4 commitment to either improved reliability or lower costs as a result of this merger.
5 Further, customers are not asking for improved reliability. Indeed, the Wisconsin utilities
6 impacted by this merger are among the most reliable utilities in the nation. Therefore,
7 customer best interests for purposes of the proposed transaction must be defined as lower
8 customer electricity costs.

9 Non-fuel O&M costs are one of the key drivers behind customer costs. WEPCO and
10 WPS non-fuel O&M costs since 2000 are developed in Exhibit 1 and shown in Figure 1.

11 **Figure 1 – Non-fuel O&M Costs (\$/MWh)**



12
13 The results show the independent management team leading WPS has produced non-
14 fuel O&M costs that are materially lower than WEPCO's costs. In 2013, WEPCO's

1 industrial rates were 34% higher than WPS (Direct-Jobs4WI-Vock-5), partially attributed
2 to non-fuel O&M costs per MWh that were 60% higher than WPS.

3 Going forward with both utilities led by a single management team, this merger will
4 only be in the “best interest” of customers if the Commission ensures that non-fuel O&M
5 cost control reflects WPS’s history and not WEPCO’s.

6 **Q. How do you describe the public’s “best interests” in relation to the proposed**
7 **transaction?**

8 A. In my view, the public will suffer if this transaction is allowed to proceed. As I
9 pointed out in my direct testimony, the PSCW will have less of a regulatory laboratory in
10 which to affect public policy if there are fewer independently managed public utilities or
11 fewer independently developed management initiatives. This will hinder the PSCW’s
12 ability to test and implement best practices within Wisconsin’s utilities to develop and
13 improve utility regulation. In essence, the PSCW will have fewer independent entities
14 with which to test and benchmark effective regulation.

15 Also, any unintended results of regulatory decisions would be amplified with WEPCO
16 and WPS service territories covering the vast majority of Wisconsin’s industry and
17 population. Any decision, whether good or bad, will be felt by a significant majority of
18 Wisconsinites. This does not benefit the public - rather, it puts the public at greater risk of
19 any unintended results.

1 **Q. How do you see this transaction affecting utility investors’ “best interest”?**

2 A. Integrysts’ investors will immediately benefit from this proposed transaction due to the
3 acquisition premium being offered for Integrysts stock; but the long-term benefits to
4 investors are far from certain. Utility investors benefit by improved access to lower bond
5 financing terms and by seeing higher share price premiums above book value. There is
6 no evidence that either of these will be provided with the proposed transaction.

7 WEC and Integrysts investors have each benefitted in the past from their independently
8 regulated utility investments. Wisconsin’s regulatory system has minimized their risks
9 while allowing generous returns. However, there is no evidence that investors will be
10 better off by combining these holding companies. The Applicants project only a small
11 earnings increase that is nearly insignificant compared to the proposed increased overall
12 corporate debt load to finance this transaction.

13 The Applicants present an unsubstantiated argument that a larger holding company
14 will produce better access to capital for the regulated utilities while ignoring the risks of
15 massive debt assumption in creating this larger holding company. The recent recession
16 clearly demonstrated that bigger is not always better and more debt is not always good.
17 Yet, these are two of the main arguments the Applicants rely on to demonstrate investor
18 benefits. (Direct-WEC-Lauber-11,12)

19 Additionally, the ratings services make a direct connection between holding company
20 ratings and regulated utility ratings. WPS suffered a credit downgrade in 2009 because
21 of Integrysts’ cash-flow issues (Exhibit 2) and WEPCO suffered a credit downgrade from

1 Moody's in 2003 in part, because of debt obligations from the WICOR merger (Exhibit
2 3).

3 I could see value for the investors if the resulting corporation can be quickly resold at
4 a premium, but that is not proposed as part of this transaction. Therefore, I am not
5 convinced that the proposed transaction is in the "best interests" of utility investors.

6 **Q. What is your response to the Applicants' statements regarding the prospective**
7 **management of non-fuel O&M costs?**

8 A. The Applicants have consistently stated that synergistic operating savings may lower
9 electric rates after waiting 5 to 10 years. (1-CL-JA-07, 2-CUB/Inter-22) In supporting
10 their 3-5% non-fuel O&M savings projections, Mr. Reed stated, "WEC has not prepared
11 a synergy study of estimated actually achieved savings for this proceeding, because the
12 proposed merger is not premised on savings..." (Rebuttal-WEC-Reed-10) I agree with
13 Mr. Reed. This merger is not supported by or based upon savings.

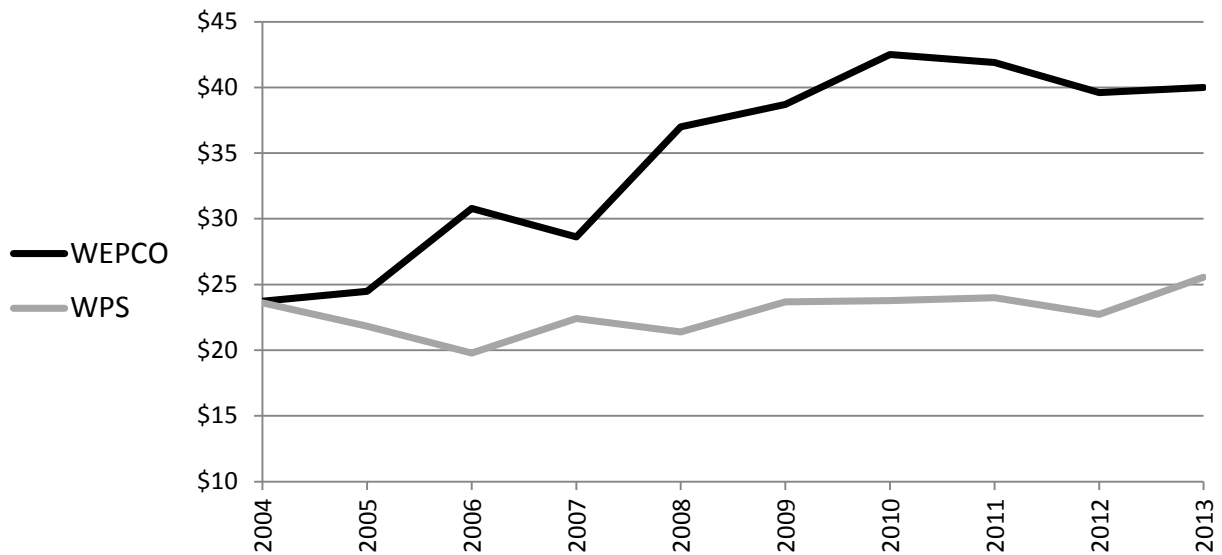
14 Mr. Reed's claims Mr. O'Donnell's merger analysis is "meaningless" without
15 providing some context. (Rebuttal-WEC-Reed-11) Likewise, I propose that Mr. Reed's
16 merger analysis is "meaningless" without providing some context. In my direct
17 testimony, I pointed out that Mr. Reed's study lacks an analysis of "variations in labor
18 costs, benefits, pension fund performance, transmission or pipeline charges, regulatory
19 differences, previous and current utility obligations and a variety of other issues that
20 materially impact non-fuel O&M costs every year." (Direct-Jobs4WI-Vock-11) But not
21 all of Mr. Reed's merger studies ignore the context.

1 In Mr. Reed's 120 page study of WEC's WICOR merger synergy "savings" from 2001
2 to 2004, Mr. Reed demonstrated \$71.2 million of savings (PSCW-01-05 Part 14 of 15-3),
3 yet Exhibit 1 reveals that non-fuel O&M costs actually increased from \$583 million to
4 \$740 million during this period. Mr. Reed's 2005 study compared actual costs to
5 projected costs of what could have hypothetically occurred without the merger. In 2005,
6 Mr. Reed provided an in-depth analysis with significant contextual analysis, what he
7 refers to as a "bottoms up" approach (PSCW-01-05 Part 14 of 15-8). Yet, today, Mr.
8 Reed states we should be satisfied with his "top down" analysis without any contextual
9 analysis.

10 I provided my own contextual analysis of non-fuel O&M cost increases in Exhibit 1,
11 which is summarized in Figure 1. This analysis tracks the non-fuel O&M costs per MWh
12 since 2000 for each utility. Figure 1 reveals the results from the different management
13 styles of WEPCO and WPS. In 2004, the non-fuel O&M costs per MWh were fairly
14 similar for both WEPCO and WPS. Since 2004, after the WICOR merger verification
15 period ended, WEPCO's costs have increased an average of 6% while WPS's costs have
16 only increased by 1% annually. This difference is shown in Figure 2 below and results in
17 a cost difference of 1.5 cents for every kWh generated.

18 I am concerned that a wholly owned WPS under the control of the Applicant's
19 management might be expected to follow WEPCO's style of management in driving
20 O&M costs higher.

Figure 2 – 2004-2013 Non-fuel O&M costs for WEPCO and WPS (\$/MWh)



Based on these results, the non-fuel O&M cost verification methods proposed by Commission Staff (Direct-PSC-Bartels-1), which are likely similar to the measures used in the WICOR merger, are insufficient to ensure sustained customer benefits. I recommend a much more definitive approach. I recommend that as a condition of this merger, recoverable non-fuel O&M costs should be reduced by 5% below their current levels for each utility for the upcoming 2017 test year. This approach gives the Applicants two years to deliver the savings they have proposed and avoids oversight which the Applicants apparently do not welcome, having labeled various recommendations “unjustifiably punitive” (Rebuttal-WEC-Lauber-4), “superfluous” (Rebuttal-WEC-Lauber-18) and “unprecedented and unwarranted micro-management” (Rebuttal-WEC-Leverett-16).

Furthermore, WEPCO's non-fuel O&M costs are not competitive compared to WPS and I urge the Commission to address this issue in future rate cases. If the Commission

1 accepts my recommendation, I also recommend that the Commission clarify that it
2 reserves the authority to further reduce recoverable non-fuel O&M costs in the future.

3 **Q. What is your response to the Applicants' statements regarding improved finance**
4 **costs and terms?**

5 A. The Applicants suggest a "bigger is better" argument for access to low-cost capital but
6 offer no proof. Mr. Reed states that the Applicants have no current problems with access
7 to capital but claims a larger utility holding company will have even better access to
8 capital. (Rebuttal-WEC-Reed-22) Mr. Reed also presents an unsubstantiated claim that
9 larger utility holding companies are more attractive to equity investors (Rebuttal-WEC-
10 Reed-30).

11 I believe WEC's current financial performance is sufficient to prove the "bigger is
12 better" assertion wrong. Prior to proposing this transaction, WEC planned to use millions
13 of dollars in cash generated from PTF and other tactics that produced revenues exceeding
14 authorized ROE by \$474 million from 2001 to 2013 (Direct-PSC-Kettle-8) to buy back
15 \$300 million of stock (Exhibit 4 - WEC 2013 10K-52) and pay down \$500 million of
16 debt (Exhibit 4 - WEC 2013 10K-54). WEC is quite appealing to equity investors
17 without a need to grow larger just for the sake of growth, as demonstrated by WEC's
18 stock return highlighted on page 3 of WEC's 2013 Annual Report and shared below in
19 Figure 3.

Figure 3 – WEC 2013 Annual Report – Page 3

TEN-YEAR PERFORMANCE (2004–2013)*

WISCONSIN ENERGY	227.1%
Dow Jones Utilities Average	170.5%
Philadelphia Utility Index	137.1%
S&P Electric Index	132.4%
Dow Jones Industrial Average	104.9%
S&P 500 Index	104.3%
NASDAQ Composite Index	133.2%

*Stock price appreciation plus reinvested dividends.

Q. What is your response to PSCW staffer Mr Detmer and Mr. Reed’s testimony regarding potential savings from joint resource planning?

A. Mr. Detmer of the Commission Staff estimates a potential \$600 million capital expenditure savings available through joint resource planning between WEPCO and WPS (Direct-PSC-Detmer-6) made available because of WEPCO's "significant and substantial reserves.” (Direct-PSC-Detmer-3) Mr. Reed points to Mr. Detmer's projections as evidence that the proposed transaction will produce customer benefits, (Rebuttal-WEC-Reed-6) but this benefit could be realized without the proposed transaction. Upon reviewing the state’s current situation, the Commission could direct WPS to purchase capacity or assets from WEPCO without needing a merger for justification. Furthermore, a joint resource plan may help avoid future unneeded capital investments, but it does not address WEPCO’s current unneeded generation capacity and costs.

1 **Q. What additional steps do you believe would be in the public's and customers' "best**
2 **interest" beyond submitting a joint resource plan?**

3 A. WEPCO has significantly overbuilt generating capacity and proceeding with this
4 merger without evaluating the option of using WEPCO's excess capacity for the benefit
5 of the public and customers would not be prudent. This merger should be conditioned
6 upon the opening of a separate docket to investigate the Applicants' combined generating
7 assets. The Applicants should submit to divestiture of, or recovery limitations on, any
8 assets that will not be "used and useful" as determined by the Commission. This could
9 include a stipulation by WEC to revisit the "untouchable" aspects of the PTF leases.

10 **Q. The Applicants challenged your direct testimony regarding the utilization of ERGS**
11 **and the benefits of PTF. Can you defend your testimony?**

12 A. Jobs4WI demonstrated that ERGS was under-utilized and overpriced, operating at a
13 23% capacity factor in 2013 with a non-competitive generating cost of 14.76 cents per
14 kWh. (Direct-Jobs4WI-Vock-6).

15 Mr. Leverett states that Jobs4WI's claims are not factual, ignored 2013 data and then
16 presented 2014 data to support his position. Yes, ERGS ran more in 2014, but capacity
17 utilization cannot be evaluated without looking at the whole picture. WEPCO was
18 authorized to model and operate ERGS as "must run" in 2014 while test-burning PRB
19 coal. (PSC Ref# : 194814, Page 7) ERGS has been running more in 2014 because
20 WEPCO is trying to make ERGS competitive with its older plants. ERGS has been
21 running because WEPCO needs it to run, not because ratepayers need it to run.

1 ERGS output increased in 2014 while the output from Oak Creek, Pleasant Prairie and
2 Port Washington decreased. (footnote: From December, 2013 WEPCO Electric Fuel
3 Cost Report-PSC Ref#: 201035 and December, 2014 WEPCO Electric Fuel Cost Report-
4 PSC Ref#: 230760) Mr. Leverett offers ERGS's availability in a single month of a
5 different year (Rebuttal-WEC-Leverett-19) as assurance that ERGS is used and useful.
6 Availability has been an issue with the Commission, (PSC REF# : 194814, Pages 4-5) but
7 it is minimally comforting to know that ERGS is available when all WEPCO customers
8 pay about a penny for every kWh for the ERGS lease, whether ERGS runs or not.
9 (footnote: from 2013 annual PSCW report - \$286 million lease from E-17; retail sales of
10 25.8 billion kWh from E-2) To make matters worse, WEPCO customers were on the
11 hook for another penny for every two kWh produced by ERGS in 2014 to pay for the
12 excessive fuel costs for this "must run" facility. (footnote: cents/kWh from December,
13 2014 WEPCO Electric Fuel Cost Report-PSC Ref#: 230760 ERGS1=2.76, ERGS2=2.56,
14 Oak Creek=2.19, PP1=2.32, PP2=2.38). So 2014 utilization does not negate ERGS's
15 2013 low utilization nor does it prove that ERGS is both used and useful.

16 I could continue to provide facts clearly demonstrating WEPCO's excess capacity and
17 the negative impact on customers, but this is not the proper forum. If the merger
18 Application is not rejected, the Commission should require a review and right-sizing of
19 the Applicants' combined generation portfolio as a condition of this merger.
20
21

1 **Q. Would you respond to Mr. Leverett's testimony on the Commission's authority over**
2 **ERGS and PTF?**

3 A. Mr. Leverett claims that Jobs4WI's testimony is "lacking a legal basis" (Rebuttal-
4 WEC-Leverett-20) stating that "Jobs4WI is asking the PSCW to do something it has no
5 legal authority to do." (Rebuttal-WEC-Leverett-19) I did not ask the Commission to take
6 any of these actions. I requested that the Applicants, alter their proposal to include
7 benefits for ratepayers as part of this proceeding. Again, this transaction must be in the
8 best interests of the customers, the public and the utility investors. All three groups must
9 benefit and it is incumbent upon the Applicants to take these interested into
10 consideration.

11 I was encouraging the Applicants to work with stakeholders and the Commission to
12 craft solutions that are in the "best interest" of everyone. Maybe they could sell firm
13 capacity into Chicago's competitive market or to Wisconsin municipal utilities that are
14 buying from AEP out of Ohio (footnote: for example, see Medford Electric Utility annual
15 PSCW Report, E-18). They could sell a portion of ERGS to WPS and another portion to
16 WP&L who is seeking additional generating capacity. They could admit PTF was a
17 failed experiment and agree by stipulation to return these assets and their ROE to PSCW
18 authority. As operators of a state-sanctioned monopoly, the public expects some level of
19 leadership or, in the alternative, at least some regard for the economic well-being of their
20 captive customers, especially with WEC's public stance as a supporter of economic
21 development and their representation in organizations like the G-7, WMC and M-WERC.

1 Instead, the Applicants offer no concrete benefits to customers, ignore risks to the
2 public and customers and continue to defend a proposal that clearly falls short of the legal
3 standard set out in Wisconsin Statute 196.795(3).

4 **Q. Has your position changed with respect to the recent developments in the Michigan**
5 **utility divestiture?**

6 A. I support divesting Michigan in concept. However, I urge the Commission to ensure
7 that any double-dipping on SSR payments is recovered and to clarify that any stranded
8 generation, transmission or distribution costs incurred for the benefit of Michigan
9 customers will remain the responsibility of Michigan ratepayers. I also believe Michigan
10 ratepayers should bear the cost for physically separating WI and MI and that all costs to
11 operate PIPP must be borne by Michigan ratepayers. Lastly, I believe the Commission
12 should investigate whether Wisconsin would gain more authority over ATC and the costs
13 incurred by Wisconsin distribution utilities if the Wisconsin and Michigan operations of
14 ATC were treated independently.

15 **Q. What do you propose for ATC ownership and control?**

16 A. Back in 1999, the State of Wisconsin determined that it was in the best interests of the
17 utility customers and investors and the public to break up the vertical monopoly utilities
18 and spin-off the transmission assets into a separate and independent transmission
19 company called the ATC. Each contributing utility was given equity shares in the ATC.
20 Since then, without PSCW rate making jurisdiction, transmission costs have increase on
21 average about 25% per year. (Direct-GLU-Kothari-5)

1 Customers want their regulated utilities to vigorously challenge transmission costs but
2 this seems unlikely if a majority of the profits from transmission revenue will benefit a
3 common holding company. Dealings between the ATC and the regulated utilities in the
4 merged holding company would seem to be much less of an arms-length transaction than
5 would otherwise be in the best interest of the public.

6 One way to avoid reintegrating the divested transmission entities at the holding
7 company level is to not allow the Applicants to have a controlling interest in ATC;
8 however, it would be preferable if the Applicants and Wisconsin's distribution utilities
9 fully divest their ownership of the ATC so it can perform as a truly independent
10 transmission system with vigorous and robust challenges to costs on a regular basis.

11 One example of how divestiture could benefit customers is the interruptible
12 transmission tariff which is available in Michigan, but not Wisconsin. To address these
13 issues, the Commission should open a separate docket to understand the options available
14 to the Commission and to seek the "best interests" of all stakeholders going forward.

15 **Q. Does this conclude your testimony?**

16 **A.** Yes it does.